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No. 1135

In the Supreme Court of the United States

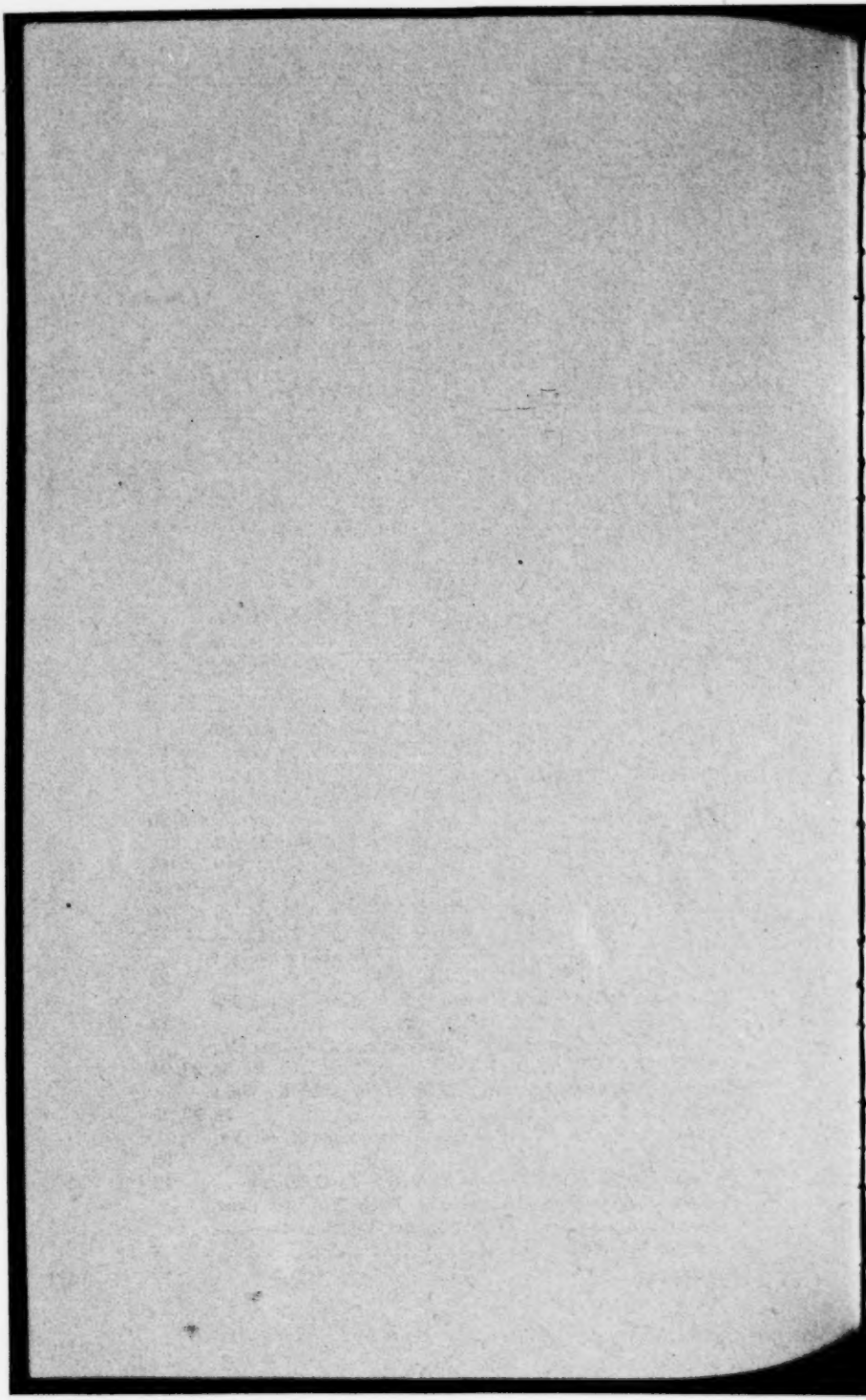
OCTOBER TERM, 1946

THE UNITED STATES, PETITIONER

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA



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The Acting Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals of the District of Columbia entered in the above-entitled case on July 16, 1946.

OPINIONS BELOW

The opinion and order of the Public Utilities Commission of the District of Columbia (R. 1–46) are reported at 55 P. U. R. (N. S.) 65. The opinion of the District Court of the United States for the District of Columbia (R. 222) is not reported. The opinions of the United States Court of Appeals for

the District of Columbia (R. 658–664) is reported at 158 F. 2d 533.

JURISDICTION

The judgment of the Court of Appeals (R. 664) was entered on July 16, 1946. A petition for rehearing (R. 665–666) seasonably filed was denied on December 17, 1946 (R. 667). The jurisdiction of this Court is invoked under the provisions of Paragraph 65 of the District of Columbia Utility Law (D. C. Code 43–705, 37 Stat. 989, as amended by 49 Stat. 882)[1] and under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Over a period of years, the Potomac Electric Power Company has accumulated a surplus of approximately $29,000,000 which, the United States contends, being composed both of amounts resulting from improper and illegal depreciation practice and of the residue of exorbitant earnings remaining after distribution of excessive common stock dividends, represents involuntary customer

[1] Prior to the Act of August 27, 1935 (49 Stat. 882, c. 742, § 2) amending the Act of March 4, 1913 (37 Stat. 974, 989, c. 150, § 8, par. 65), it was held that the jurisdiction of this Court did not encompass review of decisions of the Court of Appeals for the District of Columbia on appeal from orders entered by the Public Service Commission. *Keller* v. *Potomac Electric Power Co.*, 261 U. S. 428. However, the limitations placed on the scope of judicial review in the courts below, by the Act of August 27, 1935, would appear to cure the objections to this Court exercising jurisdiction to review the decisions in such cases.

contributions to capital on which Pepco is not entitled to a return. The question presented is whether the Public Utilities Commission should have excluded such surplus, or a portion thereof, from Pepco's rate base and common stock equity.

STATUTES INVOLVED

The pertinent provisions of the District of Columbia Utility Law (37 Stat. 974, as amended by 49 Stat. 882, D. C. Code 43–101 *et seq.*), are set forth in Appendix B, *infra,* pp. 30–36.

STATEMENT

The factual background may be summarized as follows: The Potomac Electric Power Company (Pepco) was incorporated in 1896 (R. 608) and has had, as the result of consolidation with the competing electric light and power companies, a monopoly of the electric light and power business in the District of Columbia since 1902 (R. 335). Pepco came under regulation by the Public Utilities Commission of the District of Columbia (Commission) upon the passage of the Utility Law of March 4, 1913, 37 Stat. 974. Pepco's present capital structure consists of $40,000,000 of first mortgage bonds of varying maturities issued between 1936 and 1942 (R. 33); of $7,000,000 preferred stock, the sum of a 6% issue in 1925 and a 5½% issue in 1927, costing 5.86% annually (R. 34); and of $9,000,000 of $100 par value common stock (R. 35). Of this common stock $3,755,000

does not represent investment in used and useful property [2] and $3,000,000 of the remaining $5,245,000 was issued in 1942 for cash at par to Washington Railway and Electric Company (Wreco) (R. 592). Wreco is a holding company which has always owned all of the Pepco common stock (R. 274, 319, 336), and which in turn, is controlled by North American Company, a New Jersey corporation (R. 336, 345).

As of January 1, 1925, rate litigation which had been going on between Pepco and the Commission since 1917,[3] was terminated by the entry of a consent decree. This decree established the so-called "sliding scale arrangement," which provided a formula and procedure for fixing rates (R. 57-64). Briefly, the arrangement provides as follows:

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[2] $1,000,000 represents stock issued in 1912 for certain rights in a hydroelectric site located at Great Falls on the Potomac River. By its Order No. 208 of May 2, 1917, the Commission found that the interest in that site did not represent operating property, and ordered that it be carried in the non-operating property account (R. 35, 38, 591, 593). The remaining $2,755,000 has been found by the Commission not to represent cash, property or services received by Pepco, but to have been issued partly for purported services and partly for the absorbed companies in excess of their cost, and represented intercompany profit (R. 402–5). By Commission order this amount has been charged against surplus (R. 35, 36, 404).

[3] Phases of that litigation are officially reported in *Potomac Electric Power Co.* v. *Public Utilities Commission*, 276 Fed. 327 (App. D. C.) and *Keller* v. *Potomac Electric Power Co.*, 261 U. S. 428.

1. The "fair value of property now used and useful as of January 1, 1925, of $32,500,000" was determined as the rate base (R. 58) to which there was to be added annually the "actual cost of future additions undepreciated but weighted during a period of any one year" (R. 58–59);

2. Rates were to be fixed to yield a 7½% rate of return on the undepreciated rate base plus the annual additions (R. 58);

3. A depreciation reserve of $4,000,000 as of January 1, 1925, was established. The annual depreciation rates were to vary, in accordance with the percentage ratio of the reserve to the rate base, the total reserve never to exceed 20% of the rate base. Four percent interest was to be accrued on the reserve, to be treated "as an accretion to the reserve, lessening the amount of depreciation to be included as an expense of operation" (R. 58);

4. The rates were to be revised annually upward or downward in accordance with a prescribed formula. In regard to decreases it was provided that when the "rates * * * yield more than a 7½% return" on the undepreciated rate base, "one-half of said excess shall be used in a reduction of rates to be charged * * * thereafter, * * * that is to say, by way of example, * * *, the rates * * * shall be automatically reduced by the filing of new rate schedules to absorb

[one-half] of such excess during [the succeeding] year" (R. 58–59).[4]

Rates in the District of Columbia have been reduced under the formula to a level which compares favorably with rates for other cities of comparable size (R. 6). However, in administering the sliding scale arrangement, the Commission included in the rate base not only new additions to the plant but an allowance for working capital and for materials and supplies (R. 12) and applied reductions to gross revenues, rather than to net returns (R. 41). Moreover, there have been substantial earnings in excess of the rate of return in every year but one since 1925 despite annual rate reductions and reductions in the rate of return to 7% in 1931, to 6½% in 1935 and to 6% in 1937 (R. 7). The excess earnings, as found by the Commission, total approximately $16,000,000 for the period here involved, an average of well over $800,000 per year (R. 8). The Commission has never attempted to recapture any portion of the excess earnings and has always left such ex-

[4] In regard to rate increases, the sliding scale arrangement provided "If the average return for any consecutive 5-year period falls below 7½ percent on the base ascertained as aforesaid, or if the average return for any consecutive 3-year period falls below 7 percent on the base ascertained as aforesaid, or if the average return for any consecutive 12-month period falls below 6½ percent on the base ascertained as aforesaid, the commission shall promptly increase rates so as to yield 7½ percent on the base ascertained as aforesaid" (R. 59). In this connection, it should be noted that increases were to be such "as to yield 7½% on the base."

cess, in addition to the established return on the rate base, with Pepco. Instead, in accordance with its construction of the sliding scale arrangement, the Commission, in adjusting rates for each year, has sought to fix rates which would yield the established return plus one-half of the excess of the past year.[5]

On April 26, 1943, the Commission instituted an investigation as to whether the sliding scale arrangement should be abandoned, continued, or modified, and, if modified, what changes should be made in the basic elements thereof (R. 1). Ex-

[5] In 1931 the Commission in its Order 919 found that "the rate of return yielded by the existing sliding scale is excessive and unreasonable" and reduced the established rate of return from 7½% to 7%. The Commission in that order also amended the language of the sliding scale in regard to reductions in rate to the public to read as follows:

> If the said excess [over 7%] shall be not more than 1% of the rate base, returns from the following 12 months based upon the business done during the 12 months in which such service occurred shall be adjusted so that the gross receipts of the company shall be reduced by one-half of such excess.

The order provided a schedule of brackets for reductions which was to increase as excess earnings over the basic return increased. The consequent litigation, entitled *Potomac Electric Power Company* v. *Public Utilities Commission*, Equity No. 53475 in the Supreme Court for the District of Columbia, was compromised while appeal was pending in the Court of Appeals, and provided, *inter alia*, that the percentage of earnings to be used in the reduction of rates should vary from one-half to five-sixths of such excess depending upon the actual earnings of the company. This latter schedule has been continued to the present time.

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tensive hearings were had in which the United States, through the Federal Works Agency and the Procurement Division of the Treasury Department, participated as a customer of Pepco.

On July 22, 1944, the Commission entered its Order No. 2796 (R. 45–46)—the order here involved—which made various changes in the sliding scale arrangement and other material adjustments.[6] Instead of computing the return on an undepreciated rate base and accruing 4% interest on the depreciation reserve (*supra,* p. 5), the Commission adopted a depreciated rate base to which the rate of return was to be applied. The gross rate base, as of December 31, 1943, was fixed at $98,615,-839.52[7] (R. 21, 42). To this was added an allowance for materials and supplies, but no allowance for working capital was made since the lag in the payment of expenses and taxes exceeded the lag in the collection of revenue (R. 20–21). From this total was deducted as accrued depreciation the amount of $17,844,120, which was in the depreciation reserve on December 31, 1943 (R. 26). In lieu of the sliding scale provisions for annual charges for depreciation (*supra,* p. 5), the Commission fixed the annual depreciation expense on

[6] Only two Commissioners concurred. Commissioner Hankin's term of office expired before the order was issued, but he had previously filed a dissenting opinion which substantially supports the position of the United States (R. 66–209).

[7] In adopting this figure as the gross rate base, the Commission eliminated $5,581,713.76 as being in excess of the original cost of the property included therein (R. 13).

the basis of the estimated average service lives of various classes and groups of depreciable property (R. 26, 29).

The Commission used the cost-of-capital method of determining the basic rate of return. It found that the effective interest rate on the $40,000,000 of bonds was 3.008% (R. 33, 38); that although the annual cost of the preferred stock was 5.86%, it was refundable at 5% and hence allowed only 5% (R. 34); and that return of 8% on the common stock equity constituted a liberal return and was commensurate with returns on investments in other enterprises having corresponding risks (R. 37). On this basis, it found 5.319% to be the cost of capital, and hence reduced the basic rate of return to 5.5% (R. 38), which together with the excess allowed under the sliding scale arrangement amounts to 5.82% (R. 40). In applying the rate reduction, the Commission required it to be reflected in the net, rather than gross, operating revenues. As a result of these modifications and the computations pursuant thereto, the Commission directed Pepco to file new rate schedules which, when applied to KWH consumption during the test year 1943, would reduce its net income by $257,214.77 (R. 43). This, plus the savings of $779,974.51 in federal income and excess profit taxes resulting from the reduction in net income, resulted in a total rate reduction of $1,037,189.28 (R. 43).

The Commission treated the common stock as amounting to $8,000,000 (the total issued less $1,000,000 for the contract rights to the Great Falls hydroelectric site), the surplus at $29,433,544, and the common stock equity as the sum of these items, namely, $37,440,115[8] (R. 38). It refused to exclude the $29,000,000 surplus, or a portion thereof, from the rate base and the common stock equity as urged by the United States (R. 15–17). The Commission further found that after payment of bond interest and common stock dividends, there would remain $3,250,058.78 to provide a 8.91% return on such common stock equity (R. 43). Such return, the Commission found, would "enable Pepco to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed" (R. 43).

Applications for reconsideration were seasonably filed with the Commission on behalf of the United States (R. 227, 232) and denied by the Commission (R. 231, 236). A "Petition of Appeal" was filed in the United States District Court for the District of Columbia (R. 47) which that court dismissed on the merits (R. 221.).[9] Upon appeal, the Court of Appeals affirmed the judg-

[8] The slight discrepancy between the common stock equity and the sum of the common stock and the surplus is due to minor adjustments which are not here relevant.

[9] The appeal of the United States was initially opposed in the district court on the ground that the United States as a consumer was not "affected" by Order No. 2796 and hence was without standing to seek review thereof. On appeal,

ment of the district court. It held that while "There is no question but that the Company's rates outran the Commission's efforts to cut them down under the 'sliding scale' as it has operated for the past several years [and] * * * the Commission, as a matter of working policy, should have cut more deeply with its adjustments in the 'allowable rate of return' * * *, all of this justifiable criticism represents nothing more, in our opinion, than an attack, on an 'error in judgment' by the regulatory body. Such an error does not rise to a level of an error of law" (R. 660). It rejected the contention that the $29,000,000 surplus should be excluded from the rate base, stating "We are not directed to any authority for the government's position, and we have not been able to find any. On the contrary, there is a clear line of authority holding that surplus devoted to the Company's business is properly to be considered a part of the 'invested capital' " (R. 661). The court found that contention objectionable for the further reason that "The annual orders which fixed the rates became final and conclusive when no person affected availed himself of the right to appeal. Consequently the rates so fixed became the legal rates for the periods during which they were to endure, and neither the United States nor other party affected thereby can brand them as

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the Court of Appeals sustained the right of the United States to such review. *United States* v. *Public Utilities Commission*, 151 F. 2d 609 (App. D. C.).

illegal" (R. 662). Mr. Justice Edgerton dissented.[10]

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In failing to hold that the surplus was comprised of involuntary consumer contributions upon which Pepco is not entitled to a return.

2. In holding that the Commission, in fixing Pepco's rates, was without power to exclude the surplus here involved from the rate base and the common stock equity.

3. In holding that the rates charged under the sliding scale arrangement despite the exorbitant earnings resulting thereunder, may have been just and reasonable.

4. In failing to hold that the rates which gave rise to these earnings were invalid because they "woefully neglected the interests of the consumers."

5. In holding that the United States is now estopped from objecting to the inclusion of the surplus in the rate base and the common stock equity because of its failure to appeal prior rate orders.

6. In affirming the judgment of the district court.

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[10] Pepco has also sought judicial review of Order No. 2796. The district court dismissed Pepco's "Petition of Appeal" (R. 261) and the Court of Appeals affirmed (R. 646). Pepco has filed a petition for writ of certiorari in this Court (*Potomac Electric Power Co.* v. *Public Utilities Commission et al.*, No. 1038, this Term), which is now pending.

REASONS FOR GRANTING THE WRIT

The Commission, over the objection of the United States, included in the rate base or stockholders' equity $29,000,000 of surplus which Pepco accumulated over a period of approximately nineteen years out of excessive earnings after paying exorbitantly high dividends. We think it plain that the Commission acted, and the court below affirmed that action, on the erroneous assumption that, as a matter of law, exclusion of the surplus could not be sustained. It is our view that, on the contrary, the Commission was under a legal duty to exclude such surplus in complying with the statutory mandate to approve only just and reasonable rates. But regardless of whether the law compels exclusion of that surplus, the Commission certainly had power to exclude from the rate base a surplus representing payments by the rate payers over and above just and reasonable charges for utility service. In view of the very substantial injury done to the interests of consumers, which will otherwise progressively increase in the future, we submit that this Court should correct the errors of law in the decisions below and remand the case for further proceedings.

1. It is uncontroverted that from January 1, 1925, when the sliding scale arrangement went into effect, until December 31, 1943, the end of the test year used by the Commission as the basis of

Order No. 2796, Pepco has had excess earnings, over and above the established rate of return, in the amount of $16,911,533.49, an annual average of $890,080.71 (R. 8). As appears in Table I, Appendix A, *infra,* pp. 26–27, the net income available for common stock dividends, after payment of interest on bonded indebtedness and dividends on the preferred stock, has ranged from 42.07% to 75.14% per year (an average of 59.99% per year) on stock having a par value of $6,000,000 and from 72.19% to 200% (an annual average of 156.06%) on the actual investment of $2,245,000.[11] That Table further shows that the annual dividends actually paid in these years ranged from 14% to 65% (an average of 38.31%) on the par value of the outstanding common stock, and from 37.41% to 173.71% (an average of 99.16%) on the actual investment. In the 19-year period involved, common stock dividends have averaged more than $2,300,000 a year and have totaled $45,345,000 on an investment, which for practically 18 years of that period totaled no more than $2,245,000. Thus, the average dividends paid each year have more than equalled Wreco's total actual investment during most of that period. Despite the payment of such dividends, the common stock

[11] The par value of Pepco's outstanding stock was $6,000,000 from 1925 through June 1942, and $9,000,000 thereafter. The actual investment was $2,245,000 from 1925 through June 1942, and $5,245,000 thereafter. *Supra,* pp. 3–4.

equity has increased from approximately $8,000,000 in 1925 to $38,000,000 in 1943.

The Commission and the court below held that the Commission is without power to exclude from the rate base and the common stock equity Pepco's surplus of approximately $29,000,000, which has remained after the payment of these dividends. The effect of this holding is to require the customers who have already repaid Wreco, which owns all of Pepco's common stock, its investment many times over, and who by payment of excessive rates have contributed involuntarily at least the amount of this surplus, to pay rates which will allow Pepco a return not only on the par value of its common stock, but on this surplus as well. As pointed out by Justice Edgerton in his dissent in the instant case, notwithstanding the $1,037,189 rate reduction prescribed,[12] Pepco is permitted under Order No 2796 "to earn in a single year a return upon its common stock equal to more than one-third of the par value of the stock and more than one-half the amount which it received for the stock and invested in plant" (R. 663). Such a result, we submit, does not involve a true "balancing of the investor and the consumer interests" (*Federal Power Commission* v. *Hope Natural Gas Company,* 320 U. S. 591, 603) and should not be

[12] $779,974.51 of this rate reduction represents savings in federal income and excess profits taxes, resulting from a prescribed reduction in net income of $257,214.77.

permitted without authoritative decision from this Court.

2. Before the Commission, the United States urged that the $29,000,000 surplus, being comprised of amounts resulting from improper and illegal depreciation practices and of the residue of exorbitant earnings remaining after the distribution of excessive common stock dividends, constituted an involuntary customer contribution to capital, on which Pepco was not entitled to a return, and hence should be excluded from the rate base and the common stock equity. The Commission, however, refused so to treat that surplus because, as it said, "The elimination of earned surplus or undistributed earnings from invested capital finds no support in reason or in law. On the contrary, it is universally recognized by both courts and regulatory authorities that undistributed earnings invested in the assets of a corporation are just as much a part of invested capital as are the dollars obtained from the sales of securities" (R. 15–16). The court below affirmed the Commission's action (R. 661).[13] The United States submits that the

[13] Contrary to the implication of the court below (R. 661–662), there is no question here involved as to the propriety of including in the rate base, surplus, which represents an accumulation of fair and reasonable earnings which the investors have decided to reinvest in the enterprise, rather than to withdraw in the form of dividends. It is this type of reinvestment which the Securities and Exchange Commission assumed it was discussing in the language quoted in the decision below (R. 661–662). See *Re Potomac Electric Power Company*, 8 S. E. C. 30, 36.

Commission erred as a matter of law in holding that it had no authority to exclude Pepco's surplus from the common stock equity.[14]

a. That Pepco's surplus represents amounts accumulated as the result of illegal and improper depreciation practices and of exorbitant earnings remaining after distribution of excessive common stock dividends is demonstrable.

In regard to Pepco's earnings, the Commission initially fixed the rate of return at 7½% and subsequently reduced it to 7% in 1931, to 6½%, and to 6% in 1937. That these rates of return set by the Commission were just and reasonable and adequately protected the interests of the investor is clear. This Court in 1933 upheld the sufficiency of a 7% rate of return (*Wabash Valley Electric Co.* v. *Young,* 287 U. S. 488, 502; *Los Angeles Gas & Electric Corp.* v. *R. R. Commission,* 289 U. S. 287, 319), and in 1938 it upheld, in *Driscoll* v. *Edison Light & Power Co.,* 307 U. S. 104, 120, the sufficiency of a 6% rate of return for enterprises, the risk of which was at least commensurate with, if not greater than, the risk here involved. See *Potomac Electric Power Co.* v.

[14] Paragraph 66 of the Utility Law, Appendix B, *infra,* p. 36, limits judicial review to "questions of law." The statement of the court below that although the Commission was validly subject to criticism for failing more vigorously to drive down Pepco's rates, such criticism represents nothing more than an attack on an "'error in judgment' * * * [which] does not rise to the level of an error of law" (R. 660), misconceives the error of law which the United States urged.

Public Utilities Commission, 158 F. 2d 521, 524 (App. D. C.), petition for writ of certiorari pending, No. 1038, this Term; Bussing, *Public Utility Regulation and the So-Called Sliding Scale* (1939), pp. 143–161. Despite the reasonableness of these rates of return, the Commission found that Pepco has earned, since January 1, 1925, approximately $16,000,000 in excess thereof (R. 8), and its Order No. 919 issued in 1931 recognized that the "rate of return yielded by the existing sliding scale is excessive and unreasonable" (ftn. 5, p. 7, *supra*).

The actual excess earnings are many millions of dollars greater since according to Commission practice that portion of the annual excess which is not distributed as dividends was immediately added to the rate base, which, as thus increased, was the basis used in determining whether and by how much the earning of subsequent years was excessive. These excessive earnings have resulted, we submit, from the fact that due to persistent errors of prediction or to persistent errors of interpretation by the Commission, the sliding scale arrangement has only nominally, but never effectively, been applied.[15] See Order No. 2564 of the

[15] The errors which, we believe, led to these excessive returns are (1) failure of the Commission to require recapture in some way, or the actual "absorption" of, any part of the annual excesses; (2) applications of reductions to gross, rather than net, income, which became important with the incidence of high federal taxes; (3) the illegal depreciation practices discussed, *infra*, pp. 19–21; (4) the assumption in fixing rates for each new year that operating volume and expenses would

Public Utilities Commission of the District of Columbia, dated April 26, 1943 (R. 567–573). Such earnings indicate plainly that the rates which produced these earnings were excessive (*Dayton-Goose Creek Ry.* v. *United States,* 263 U. S. 456, 483). Since the rates were excessive, they were unlawful and violative of Paragraph 2 of the Utility Law (Appendix B, *infra,* p. 30), which provides that all charges "shall be reasonable, just and nondiscriminatory. Every unjust or unreasonable or unreasonable or discriminatory charge * * * is prohibited and is hereby declared unlawful."[16] Moreover, being in excess of just and reasonable rates, they returned to Pepco more than was required to reimburse it for the service rendered, and accordingly, the excess represents involuntary customer contributions to the enterprise. Cf. *Re Hope Natural Gas Company,* 44 P. U. R. (N. S.) 1, 12, 40; *Re Mondovi Telephone Company,* P. U. R. 1933 B (Wis.) 319, 322.

In regard to depreciation, Paragraph 16 of the Utility Law, Appendix B, *infra,* pp. 30–31, provides:

> * * * every public utility shall carry a proper and adequate depreciation account

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remain static (but see Bussing, *supra,* at pp. 143–161; Barnes, *The Economics of Public Utility Regulation* (1942) p. 237); (5) the addition of the annual excesses to the rate base and the common stock equity.

[16] These rates also violated that provision of Paragraph 18 of the Utility Law, Appendix B, *infra,* pp. 31–32, that no sliding scale or similar arrangements shall be lawful unless it be "practicable and advantageous to the parties interested."

> The commission shall ascertain and determine what are the proper and adequate rates of depreciation of the several classes of property of each public utility. * * * All moneys in this fund may be expended in keeping the property of such public utility in repair * * *, and, if invested, the income from the investments shall also be carried in the depreciation fund.

Despite these provisions, the sliding scale arrangement established a single rate of depreciation for the entire rate base in which certain nondepreciable items such as land and working capital were included even for depreciation purposes (R. 12, 35, 58). But more important still, under the sliding scale arrangement, the money paid into the reserve was reinvested in the plant and added to the undepreciated rate base. Although the rate of return on this rate base was initially established at 7½%, and subsequently reduced progressively to 6%, Pepco was never required to pay more than 4% on the money in the depreciation reserve and was permitted to retain the difference between the 4% charge and the rate of return allowed thereon as a result of inclusion in the undepreciated rate base. Clearly, then, the provisions of the sliding scale arrangement violated the basic depreciation principles established in Paragraph 16 of the Utility Law, which the Commission and Pepco were without power to ignore even when agreeing upon a sliding scale arrangement as permitted by Paragraph 18. Accordingly,

the differential between 4% and the rate of return allowed represents an unearned increment contributed by Pepco's customers. Cf. *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 595–596. Table II, Appendix A, *infra*, p. 28, shows that as a result of such depreciation practice, Pepco's surplus has been enhanced by approximately $9,000,000 since 1925. Moreover, as has been already pointed out, the rate of return which Pepco actually realized each year was greatly in excess of the rate of return established by the Commission, thereby increasing substantially the unearned increment accruing to Pepco as the result of this practice. Table III, Appendix A, *infra*, p. 29, shows enhancement of surplus in the amount of approximately $16,000,000 when interest is computed at the rate of return actually earned.

b. Thus, Pepco's surplus plainly is comprised of amounts resulting from improper and illegal depreciation practices and of the residue of excessive earnings remaining after the payment of excessive common stock dividends, and hence consists of involuntary customer contributions to capital. The Commission, we submit, should have excluded such contributions from the rate base and the common stock equity.

Although this Court has never passed on the exclusion of such contributions when they have appeared in the surplus account, this question was expressly reserved in *Louisiana R. R. Commission*

v. *Cumberland Telephone Co.*, 212 U. S. 414, at 425, and there is a respectable body of authority sanctioning such exclusion when as a result of improper depreciation practices, the depreciation reserve itself has become grossly excessive. See, e. g., *Louisiana R. R. Commission* v. *Cumberland Telephone Co., supra,* at 424–425; *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, 158–159; *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151, 168–169, 175; *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591, 597, n. 5, 599, 643, 644; *Federal Power Commission* v. *Natural Gas Pipeline Co., supra,* at 592–593; *Natural Gas Co.* v. *Public Service Commission*, 95 W. Va. 557, 571–572; *Re Mondovi Telephone Company*, P. U. R. 1933 B (Wis.) 319, 322; *Logan* v. *Bismarck Water Supply Co.*, P. U. R. 1923 B (N. D.) 450, 497–498; 2 Bonbright, *Valuation of Property*, 1139. As pointed out in the *Cumberland Telephone Co.* case, *supra,* "That it was right to raise more money to pay for depreciation than was actually disbursed for the particular year there can be no doubt, * * * but to raise more than money enough for the purpose and place the balance to the credit of capital upon which to pay dividends cannot be proper treatment" (212 U. S. at 425). That is so because "Customers who have unwittingly been financing property additions [by charges to operating expenses made by the company for capital additions] should not be expected to pay

rates which will allow a return on the property so paid for." *Re Mondovi Telephone Company, supra,* at 322. "[To make an allowance of amortization in excess of cost] would not be the computation of a proper expense, but instead the allowance of additional profit over and above fair return. Manifestly such an additional return would unjustly penalize consumers." *Federal Power Commission* v. *Natural Gas Pipeline Co., supra,* at 593, quoting with approval the opinion of the Federal Power Commission. This reasoning, we submit, is applicable irrespective of the particular account in which the contributions appear.[17]

Moreover, it is basic that an investor in a utility is entitled solely to a return on his actual investment, *Louisiana R. R. Comm.* v. *Cumberland Telephone Co., supra,* at 425; *Re Hope Natural Gas Company,* 44 P. U. R. (N. S.) 1, 12, 40; cf. *Federal Power Commission* v. *Natural Gas Pipe Line Co., supra,* at 590–591; *Southwestern Bell Telephone Co.* v. *Public Service Commission,* 262 U. S. 276, 290, 291 (Brandeis, J., dissenting) and not to any return on property constructed and financed

[17] *Board of Public Utility Commissioners* v. *New York Telephone Co.*, 271 U. S. 23, is not inconsistent with this position, since in that case, the Commissioners had directed the company to make up current losses out of reserves accumulated in the past. No question was raised there in regard to excluding from the rate base or common stock equity involuntary customer contributions. Cf. *Smith* v. *Ill. Bell Telephone Co.*, 282 U. S. 133, 158; *Wheeling* v. *Natural Gas Co.*, 115 W. Va. 149.

by customer contributions. *Louisiana R. R. Comm.* v. *Cumberland Telephone Co., supra,* at 424 *et seq; Lindheimer* v. *Illinois Bell Telephone Co., supra,* at 169, 174; cf. *Detroit Edison Co.* v. *Commissioner of Internal Revenue,* 319 U. S. 98. Apparently, for that reason the Commission in the present case without discussion excluded from the rate base voluntary contributions made in aid of construction (R. 21). The fact that the customers have made these contributions involuntarily as a result of being charged illegal rates, rather than voluntarily, does not provide a rational basis for treating the two situations differently.

c. The fact that no appeal had been taken from the Commission's annual rate orders and the rates there set became the legal rates, is not an obstacle to the present exclusion of the $29,000,000 surplus from the rate base and the common stock equity. While the rates were legal in the sense that Pepco could not depart therefrom, (Paragraphs 24 and 30 of the Utility Law, Appendix B, *infra,* pp. 32–33), they nevertheless were unlawful inasmuch as they were "unjust [and] unreasonable" and violated Paragraph 2 of the Utility Law. "In other words, the legal rate was not made by the statute the lawful rate—it was lawful only if it was reasonable." *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Ry. Co.,* 284 U. S. 370, 384. Moreover, the United States is not seeking to upset these past rates, but rather, to assure

that the rates presently fixed are just and reasonable. As Justice Edgerton, dissenting, points out, "history has an important bearing on what is presently fair" (R. 663). Cf. *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, 158.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

GEORGE T. WASHINGTON,
Acting Solicitor General.

MARCH 1947

APPENDIX A

TABLE I

Year	Common-stock equity [1] (weighted) (stock and surplus)	Income available for common stock	Common-stock dividends	Percent of earnings on—			Percent of dividends on—		
				Common-stock equity	Par value [2]	Investment [3]	Common-stock equity	Par value [2]	Investment [4]
1925	$8,126,886.45	$2,598,289.50	$840,000.00	31.97	43.30	115	10.34	14.00	37.41
1926	10,042,743.09	2,799,940.62	960,000.00	27.88	46.67	124	9.56	16.00	42.76
1927	11,955,192.05	2,980,336.59	1,080,000.00	24.93	49.67	132	9.03	18.00	48.10
1928	13,967,351.40	3,506,743.91	1,200,000.00	25.11	58.45	156	8.59	20.00	53.45
1929	16,482,101.06	3,899,687.56	1,320,000.00	23.66	64.99	173	8.01	22.00	58.79
1930	19,810,829.98	4,372,013.70	1,440,000.00	22.07	72.87	194	7.27	24.00	64.14
1931	23,344,058.65	4,202,255.29	1,560,000.00	18.00	70.04	187	6.68	26.00	69.48
1932	25,951,080.26	4,100,602.51	1,680,000.00	15.80	68.34	182	6.47	28.00	74.82
1933	28,375,603.29	3,996,359.64	1,800,000.00	14.08	66.61	178	6.34	30.00	80.17
1934	30,557,743.97	3,637,784.07	2,280,000.00	11.90	60.63	162	7.46	38.00	101.55
1935	31,900,139.28	3,630,460.99	2,550,000.00	11.38	60.51	161	7.99	42.50	113.58
1936	33,235,529.37	4,093,619.98	3,600,000.00	12.32	68.23	182	10.83	60.00	160.35
1937	33,943,624.84	4,508,267.78	3,900,000.00	13.28	75.14	200	11.49	65.00	173.71
1938	34,520,977.37	3,710,454.28	3,900,000.00	10.75	61.84	165	11.30	65.00	173.71
1939	34,334,538.55	3,851,566.32	3,900,000.00	11.22	64.19	171	11.36	65.00	173.71
1940	34,288,544.67	3,575,306.01	3,540,000.00	10.43	59.59	159	10.32	59.00	157.68
1941	34,369,830.96	3,560,007.46	3,540,000.00	10.36	59.33	158	10.30	59.00	157.68
1942	35,914,645.60	3,551,074.81	3,105,000.00	9.89	47.35	94	8.65	[4] 41.40	[5] 82.91
1943	38,073,421.00	[6] 3,786,418.00	[7] 3,150,000.00	9.94	42.07	72.19	8.27	35.00	[5] 60.00
Total		70,361,189.02	45,345,000.00	[8] 16.58	[8] 59.99	[8] 156.06	[8] 8.96	[8] 38.31	[8] 99.16

[1] The figures in this column, except in 1943, are taken from Ex. 2, Sch. 1, col. 6, (R. 527). The 1943 figure is derived from the Sept. 30, 1943, figure (Ex. 27, Sch. 1, R. 586, and R. 35 and 38) with appropriate adjustments to Dec. 31, 1943.

[2] $6,300,000 from 1925 through June 1942 and $9,000,000 from July 1942 through Dec. 31, 1943. Figures in this column taken from R. 279.

[3] $2,245,000 from 1925 through June 1942 and $5,245,000 from July 1942 through Dec. 31, 1943. Figures in this column taken from R. 279.

[4] Based on an average of $7,500,000 par value for the year 1942.

[5] Based on an average investment of $3,745,000 for the year 1942.

[6] Ex. 73, R. 606.

[7] R. 486.

[8] Average.

TABLE II.—*Amount by which Pepco's surplus has been enhanced as a result of crediting depreciation reserve with interest at only 4 percent (as required by sliding scale arrangement) rather than interest at the allowed basic rate of return*

Year	Allowed basic rate of return	Interest on depreciation reserve		Annual deficiencies in interest credit (col. 3 minus col. 4)	Interest for the year, at allowed basic rate of return, on the sum of the deficiencies of prior years and interest thereon [1]	Annual amount by which surplus enhanced (col. 5+col. 6)
		Calculated at the allowed basic rate of return	Actually credited at 4 percent			
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1925	7.5%	$323,043.56	$172,289.90	$150,753.66	0	$150,753.66
1926	7.5%	376,870.71	200,997.71	175,873.00	$11,306.52	187,179.52
1927	7.5%	428,422.54	228,492.02	199,930.52	25,344.99	225,275.51
1928	7.5%	487,480.85	259,989.79	227,491.06	42,240.65	269,731.71
1929	7.5%	549,525.49	293,080.26	256,445.23	62,470.53	318,915.76
1930	7.5%	612,834.75	326,845.20	285,989.55	86,389.21	372,378.76
1931	7.0%	630,852.78	360,487.30	270,365.48	106,696.44	377,061.92
1932	7.0%	686,762.25	392,435.57	294,326.68	133,090.78	427,417.46
1933	7.0%	745,427.71	425,958.69	319,469.02	163,010.00	482,479.02
1934	7.0%	703,078.28	401,759.02	301,319.26	196,783.53	498,102.79
1935	6.5%	709,752.77	436,770.94	272,981.83	215,104.25	488,086.08
1936	6.5%	765,857.42	471,296.88	294,560.54	246,829.84	541,390.38
1937	6.0%	746,479.75	497,653.17	248,826.58	260,326.35	509,152.93
1938	6.0%	785,488.69	523,659.13	261,829.56	290,875.53	552,705.09
1939	6.0%	837,040.64	558,027.10	279,013.54	324,037.84	603,051.38
1940	6.0%	895,321.72	596,881.15	298,440.57	360,220.92	658,661.49
1941	6.0%	923,266.46	615,510.98	307,755.48	399,740.61	707,496.09
1942	6.0%	940,824.94	627,216.63	313,608.31	442,190.37	755,798.68
1943	6.0%	1,047,954.00	698,636.00	349,318.00	487,538.29	836,856.29
Total		13,196,285.31	8,087,987.44	5,108,297.87	3,854,196.65	8,962,494.52

[1] Calculated at the rate of interest in column 2 on the amount which is the total of the deficiencies of prior years shown in column 5 and the amount on the preceding line in column 6.

TABLE III.—*Amount by which Pepco's surplus has been enhanced as a result of crediting depreciation reserve with interest at only 4 percent (as required by sliding scale arrangement) rather than interest at the rate of return actually earned*

Year	Rate of return earned as computed by Commission	Interest on depreciation reserve		Annual deficiencies in interest credit (col. 3 minus col. 4)	Interest for the year, at the rate of return earned (col. 2), on the sum of the deficiencies of prior years and interest thereon [1]	Annual amount by which surplus enhanced (col. 5 plus col. 6)
		Calculated at rate of return actually earned	Actually credited at 4 percent			
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1925	9.59%	$413,065.03	$172,289.90	$240,775.13		$240,775.13
1926	9.72%	488,424.43	200,997.71	287,426.72	$23,403.34	310,830.06
1927	9.22%	526,674.10	228,492.02	298,182.08	50,858.00	349,040.08
1928	10.28%	668,173.76	259,989.79	408,183.97	92,586.33	500,770.30
1929	10.34%	757,612.47	293,080.26	464,532.21	144,906.37	609,438.58
1930	10.71%	875,128.02	326,845.20	548,383.82	215,362.48	763,645.30
1931	9.56%	861,564.64	360,487.30	501,077.34	265,242.15	766,319.49
1932	8.80%	863,358.25	392,435.57	470,922.68	311,592.07	782,514.75
1933	8.23%	876,410.00	425,958.69	450,451.31	355,810.36	806,261.67
1934	7.45%	748,276.17	401,759.02	346,517.15	382,154.85	728,672.00
1935	7.42%	810,210.09	436,770.94	373,439.15	434,683.44	808,122.59
1936	7.91%	931,989.58	471,296.88	460,692.70	527,311.45	988,004.15
1937	7.95%	989,085.67	497,653.17	491,432.50	608,524.33	1,099,956.83
1938	7.02%	919,021.77	523,659.13	395,362.64	614,555.44	1,009,918.08
1939	7.39%	1,030,955.06	558,027.10	472,927.96	721,579.48	1,194,507.44
1940	6.79%	1,013,205.75	596,881.15	416,324.60	744,100.92	1,160,425.52
1941	5.99%	921,727.69	615,510.98	306,216.71	725,940.20	1,032,156.91
1942	6.62%	1,038,043.52	627,216.63	410,826.89	870,619.95	1,281,446.84
1943	6.74%	1,177,201.66	698,636.00	478,565.66	972,771.10	1,451,336.76
Total		15,910,127.66	8,087,987.44	7,822,140.22	8,062,002.26	15,884,142.48

[1] Calculated at the rate of interest in col. 2 on the amount which is the total of the deficiencies of prior years shown in col. 5 and the amount on the preceding line in col. 6.

APPENDIX B

The pertinent provisions of the District of Columbia Utility Law, 37 Stat. 974, as amended by 49 Stat. 882, D. C. Code (1940) 43–101 *et seq.* follow:

> PAR. 2. That every public utility doing business within the District of Columbia is required to furnish service and facilities reasonably safe and adequate and in all respects just and reasonable. The charge made by any such public utility for any facility or services furnished or rendered, or to be furnished or rendered, shall be reasonable, just, and nondiscriminatory. Every unjust or unreasonable or discriminatory charge for such facility or service is prohibited and is hereby declared unlawful. Every public utility is hereby required to obey the lawful orders of the commission created by this section.
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> * * * * *
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> PAR. 16. That every public utility shall carry a proper and adequate depreciation account. The commission shall ascertain and determine what are the proper and adequate rates of depreciation of the several classes of property of each public utility. These rates shall be such as will provide the amounts required over and above the expense of maintenance to keep such property in a state of efficiency corresponding to the progress of the industry. Each public utility shall conform its depreciation accounts to such rates so ascertained and deter-

mined by the commission. The commission may make changes in such rates of depreciation from time to time as it may find to be necessary. The commission shall also prescribe rules, regulations, and forms of accounts regarding such depreciation which the public utility is required to carry into effect. The commission shall provide for such depreciation in fixing the rates, tolls, and charges to be paid by the public. All moneys in this fund may be expended in keeping the property of such public utility in repair and good and serviceable condition for the use to which it is devoted, or invested, and, if invested, the income from the investments shall also be carried in the depreciation fund. This fund and the proceeds thereof shall be used for no other purpose than as provided in this paragraph, unless with the consent and by order of the commission.

* * * * *

PAR. 18. That nothing in this section shall be taken to prohibit a public utility, with the consent of the commission, from providing a sliding scale of rates and dividends according to what is commonly known as the Boston sliding scale, or other financial device that may be practicable and advantageous to the parties interested. No such arrangement or device shall be lawful until it shall be found by the commission, after investigation, to be reasonable and just and not inconsistent with the purposes of this section. Such arrangement shall be under the supervision and regulation of the commission. The commission shall ascertain, determine, and order such rates, charges, and regulations, and the duration thereof, as may be necessary to give effect

to such arrangement, but the right and power to make such other and further changes in rates, charges, and regulations as the commission may ascertain and determine to be necessary and reasonable, and the right to alter or amend all orders relative thereto, is reserved and vested in the commission notwithstanding any such arrangement and mutual agreement.

* * * * *

PAR. 24. That every public utility shall file with the commission, within a time to be fixed by the commission, schedules, which shall be open to public inspection, showing all rates, tolls, and charges which it has established and which are in force at the time for any service performed by it within the District of Columbia, or for any service in connection therewith or performed by any public utility controlled or operated by it. The rates, tolls, and charges shown on such schedules shall not exceed the rates, tolls, and charges now allowed by law, and shall be the lawful rates, tolls and charges within the District of Columbia, and shall remain and be in force until set aside by the commission.

* * * * *

PAR. 30. That it shall be unlawful for any public utility to charge, demand, collect, or receive a greater or less compensation for any service performed by it within the District of Columbia, or for any service in connection therewith, than is specified in such printed schedules, including schedules of joint rates, as may at the time be in force, or to demand, collect, or receive any rate, toll, or charge not specified in such schedules. The rates, tolls, and charges named therein shall be the lawful rates,

tolls, and charges until the same are changed as provided in this section.

* * * * *

PAR. 64. * * * That any public utility or any other person or corporation affected by any final order or decision of the Commission may, within thirty days after the publication thereof, file with the Commission an application in writing requesting a reconsideration of the matters involved, and stating specifically the errors claimed as grounds for such reconsideration. No public utility, or other person or corporation shall in any court urge or rely on any ground not so set forth in said application. The Commission, within thirty days after the filing of such application, shall either grant or deny it. Failure by the Commission to act upon such application within such period shall be deemed a denial thereof. If such application be granted, the Commission, after giving notice thereof to all interested parties, shall, either with or without hearing, rescind, modify, or affirm its order or decision. The filing of such an application shall act as a stay upon the execution of the order or decision of the Commission until the final action of the Commission upon the application: *Provided,* That upon written consent of the utility such order or decision shall not be stayed unless otherwise ordered by the Commission. No appeal shall lie from any order of the Commission unless an application for reconsideration shall have been first made and determined.

* * * * *

PAR. 65. The District Court of the United States for the District of Columbia shall have jurisdiction to hear and determine

any appeal from an order or decision of the Commission. Any public utility, or any other person or corporation affected by any final order or decision of the Commission, other than an order fixing or determining the value of the property of a public utility in a proceeding solely for that purpose, may within sixty days after final action by the Commission upon the petition for reconsideration, file with the clerk of the District Court of the United States for the District of Columbia, a petition of appeal setting forth the reasons for such appeal and the relief sought; at the same time such appellant shall file with the Commission notice in writing of the appeal together with a copy of the petition. Within twenty days of the receipt of such notice of appeal the Commission shall file with the clerk of the said court the record, including a transcript of all proceedings had and testimony taken before the Commission, duly certified, upon which the said order or decision of the Commission was based, together with a statement of its findings of fact and conclusions upon the said record, and a copy of the application for reconsideration, and the orders entered thereon: *Provided,* That the parties, with the consent and approval of the Commission, may stipulate in writing that only certain portions of the record be transcribed and transmitted. Within this period the Commission or any other interested party shall answer, demur, or otherwise move or plead. Thereupon the appeal shall be at issue and ready for hearing. All such proceedings shall have precedence over any civil cause of a different nature pending in said court, and the District Court of the United States for the District of Columbia shall always be

deemed open for the hearing thereof. Any such appeal shall be heard upon the record before the Commission, and no new or additional evidence shall be received by the said court. The said court, or any justice or justices thereof, before whom any such appeal shall be heard, may require and direct the Commission to receive additional evidence upon any subject related to the issues on said appeal concerning which evidence was improperly excluded in the hearing before the Commission or upon which the record may contain no substantial evidence. Upon receipt of such requirement and direction the Commission shall receive such evidence and without unreasonable delay shall transmit to the said court the findings of fact made thereon by the Commission and the conclusions of the Commission upon the said facts.

Upon the conclusion of its hearing of any such appeal the court shall either dismiss the said appeal and affirm the order or decision of the Commission or sustain the appeal and vacate the Commission's order or decision. In either event the court shall accompany its order by a statement of its reasons for its action, and in the case of the vacation of an order or decision of the Commission the statement shall relate the particulars in and the extent to which such order or decision was defective.

Any party, including said Commission, may appeal from the order or decree of said court to the Court of Appeals of the District of Columbia, which shall thereupon have and take jurisdiction in every such appeal. Thereafter the Supreme Court of the United States may, upon a petition for certiorari granted in its discretion, review the said case.

Said Commission shall not, nor shall any of its members, officers, agents, or employees, be taxed with any costs, nor shall they or any of them be required to give any supersedeas bond or security for costs or damages on any appeal whatsoever. Said Commission, or any of its members, officers, agents, or employees, shall not be liable to suit or action or for any judgment or decree for any damages, loss, or injury claimed by any public utility or person, nor required in any case to make any deposit for costs or pay for any service to the clerks of any court or to the marshal of the United States.

PAR. 66. In the determination of any appeal from an order or decision of the Commission the review by the court shall be limited to questions of law, including constitutional questions; and the findings of fact by the Commission shall be conclusive unless it shall appear that such findings of the Commission are unreasonable, arbitrary or capricious.

* * * * *

PAR. 75. That no public utility shall declare any stock, bond, or scrip dividend or divide the proceeds of the sale of any stock, bond, or scrip among its stockholders.

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